Developments in Canada's trade
and foreign investment in 1997

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DEVELOPMENTS IN CANADA'S TRADE AND FOREIGN INVESTMENT IN 1997

by

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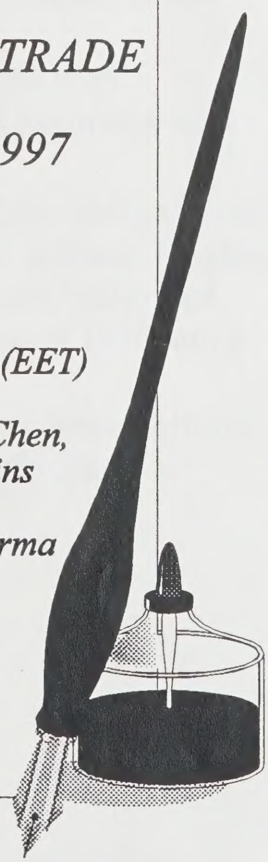

(March 1998)

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Executive Summary

In 1997:

- Real Canadian exports of goods and services grew by 8.6%, which was higher than the 5.7% recorded in 1996.
- The growth of real imports of goods and services was 13.4%, a more than two and half fold increase over the 1996 growth of 5.2%.
- Canada's trade surplus in 1997 was $23.4 billion, lower than the banner years 1995 and 1996, but much larger than that in the 1980s and the early 1990s.
- The growth of Canadian merchandise exports was led by the consumer goods sector, followed by a strong performance of the machinery and equipment, and the automotive sectors.
- Real exports of services advanced by 4.9% over the 1996 level.
- The share of knowledge-intensive commercial services exports in total service exports increased to 48%.
- The trade account surplus was more than offset by a higher deficit in net investment income flows resulting in a negative current account. Higher profits earned by foreign corporations in Canada and a net outflow of income on investment turned the current account surplus of 1996 into a $17 billion deficit in 1997.
- The current account deficit was largely financed by short-term portfolio investment by foreigners in Canadian securities and bank deposits.

Developments in Canada's Trade and Foreign Investment in 1997

In early March 1998, Statistics Canada released Canada's international payments statistics for 1997, an overall summary of Canada's international economic activity for the year. The purpose of this commentary is to report and analyze the major developments for the year as a whole.

This report follows the structure of international payments that are organized as follows[1]:

(a) The current account, which consists of net trade in goods as well as services and net investment income payments to foreigners

(b) The capital and financial account, which consists of short and long term direct foreign investment by foreigners and by Canadian investment abroad.

☞ The Canadian economy and trade in 1997

In 1997:

- The real GDP growth rate in Canada more than tripled to a robust 3.8% from 1.2% in 1996.
- The growth of real exports of goods and services was 8.6% compared to 5.7% the previous year.
- Real imports of goods and services grew by 13.4%, a more than two and half fold increase over the 1996 growth of 5.2%.
- The Canadian economy created 265 thousand additional jobs as employment growth rate performance reached a solid 1.9 % rate (see Table 1).

[1] Data in this report are on a balance-of-payments basis as well as seasonally adjusted. The source is Statistics Canada.

Table 1: New jobs, economic prosperity and inflation-adjusted export growth in Canada, 1992-97					
Years	*Real total exports to real GDP ratio*	*Real GDP growth rate*	*Real total export growth rate*	*Employment growth in thousands*	*Employment growth rate*
1992	27.2%	0.9%	7.9%	-71	-0.6%
1993	29.7%	2.5%	12.0%	173	1.4%
1994	31.9%	3.9%	11.8%	277	2.1%
1995	34.2%	2.2%	9.3%	214	1.6%
1996	35.7%	1.2%	5.7%	170	1.2%
1997	37.3%	3.8%	8.6%	265	1.9%

Between 1992 and 1997, the export price index increased from 100 to 121. In order to account for adjustments in price changes, the data in real values are reported in Table 1. In 1997, the real export growth rate increased to 8.6%, more than twice the growth in real GDP.

As seen in Table 1, between 1992 and 1996, annual growth of real exports was roughly four times the annual growth rate of real GDP in Canada. As a result:

- The share of real exports of goods and services in real GDP increased 10 percentage points between 1992 and 1997.
- Partly due to stronger trade performance in this period, the Canadian economy has created over 1 million new jobs, while the labour force grew from 14.5 million to 15.4 million.

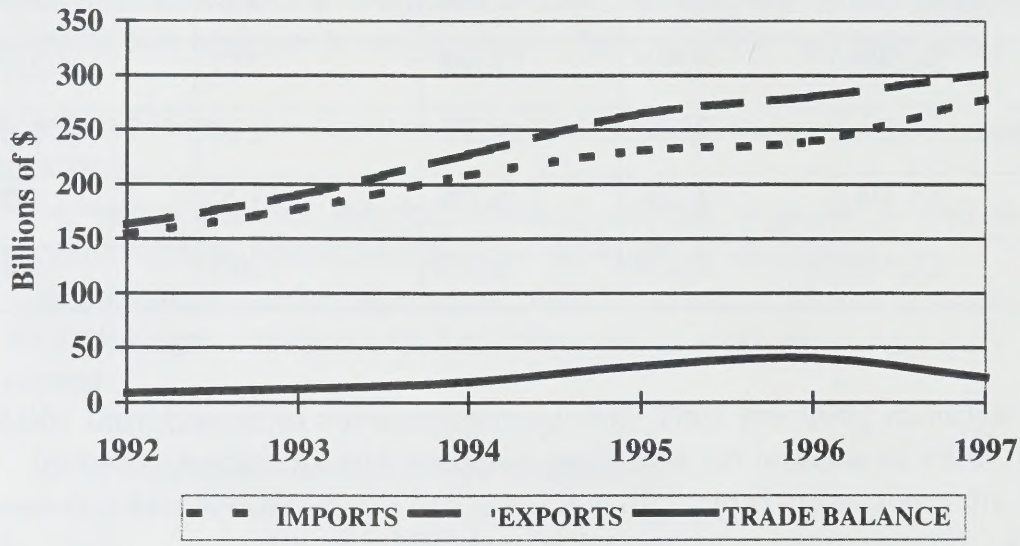
☞ **Canada's Net Trade in Goods**

- In 1997, Canada exported goods worth $301.6 billion, a record achievement.

- Canada's imports of goods in 1997 totalled a record $278.2 billion, reflecting stronger economic conditions in Canada.

- Canada's trade surplus in 1997 was $23.4 billion, lower than the banner years 1995 and 1996, but much larger than that in the 1980s and the early 1990s.

Figure 1. Canada's Merchandise Trade



Imports. Strong domestic demand resulted in real growth in imports of 18.7% in 1997. Canadian imports in 1997 had grown by 80.2% in comparison to 1992, the trough phase of the current business cycle (see Table 2).

Exports. In 1997, Canadian exports advanced (inflation-adjusted) by 8.6% over the 1996 rate of 5.7%. Strong real GDP growth in the U.S., our largest trading partner, resulted in a robust 10% increase in exports to the U.S. in 1997. Canadian exports also grew to South America and Africa. However, export growth with Asia declined marginally and turned negative with Europe in 1997. Between 1992 and 1997, Canada's overall merchandise exports had grown by 84.5%.

Table 2. Canada's Trade in Goods, 1992 and 1997

Product/ Industry		1992 (Millions)	Share in total 1992	1997 (Millions)	Share in total 1997 (%)	Growth 1992-97 (%)
Agricultural and fishing products	Exports	$15,339	9.4%	$24,624	8.2%	60.5%
	Imports	$9,736	6.3%	$15,549	5.6%	59.7%
	Balance	$5,603		$9,075		62.0%
Energy products	Exports	$15,452	9.5%	$27,872	9.2%	80.4%
	Imports	$6,478	4.2%	$10,582	3.8%	63.4%
	Balance	$8,974		$17,290		92.7%
Forestry products	Exports	$20,017	12.2%	$34,942	11.6%	74.6%
	Imports	$1,387	0.9%	$2,372	0.9%	71.0%
	Balance	$18,630		$32,570		74.8%
Industrial goods	Exports	$32,380	19.8%	$55,432	18.4%	71.2%
	Imports	$27,278	17.7%	$54,339	19.5%	99.2%
	Balance	$5,102		$1,093		-78.6%
Machinery and equipment	Exports	$31,893	19.5%	$67,528	22.4%	111.7%
	Imports	$46,674	30.2%	$91,118	32.7%	95.2%
	Balance	-$14,781		-$23,590		59.6%
Automotive products	Exports	$38,101	23.3%	$70,029	23.2%	83.8%
	Imports	$33,680	21.8%	$60,599	21.8%	79.9%
	Balance	$4,421		$9,430		113.3%
Consumer goods	Exports	$4,469	2.7%	$10,674	3.5%	138.8%
	Imports	$18,943	12.3%	$29,586	10.6%	56.2%
	Balance	-$14,474		-$18,912		30.7%
Total trade in goods	Exports	$163,464		$301,601		84.5%
	Imports	$154,430		$278,237		80.2%
	Balance	$9,034		$23,363		158.6%

Sectoral trade picture

- The growth of Canadian merchandise exports and imports was led by the consumer goods sector, followed by a strong performance of the machinery and equipment, and the automotive sectors. This development suggests broadening of the knowledge intensity even in traditional and emerging sectors in the Canadian economy.

M&E: The most noticeable change in Canadian merchandise trade in 1997 was in machinery and equipment sector (M&E). Imports of M&E

totalled $91.1 billion, an increase of 95% compared to 1992 (a 19% increase in 1997 alone), which has significantly expanded production and export capacity in Canada since the recession of the early 1990s. M&E was recorded in 1997 as the single largest import sector at almost 32% of overall merchandise imports in 1997.

Exports of M&E registered a solid growth of 111% between 1992 and 1997, and were $67.5 billion in 1997.

- Since 1993, exports of machinery and equipment have been consistently higher than the exports of industrial goods (largely the traditional Canadian exports, such as mineral products and base metals).
- Should the growth rate of M&E exports hold, it is possible that M&E sector could dislodge the automotive sector as the single largest Canadian exporting sector in the future.

Consumer products: The growth of the domestic economy in 1997 and the subsequent increase in consumer confidence along with decade-low interest rates translated into a strong import demand for foreign consumer goods.

- Exports of consumer products continued their upward trend and had grown by over 138% since 1992, the highest growth among the different sectors. In 1997, exports of consumer products grew by 12.4%.

Automotive products: Canadian exports of automotive products were $70 billion and had grown by 10.5% over the 1996 level of $63.4 billion. Canadian imports of automotive products totalled $60.6 billion in 1997, and had grown 18% over the previous year.

- In 1997, automotive products were the single largest export category, accounting for over 23% of total Canadian exports.

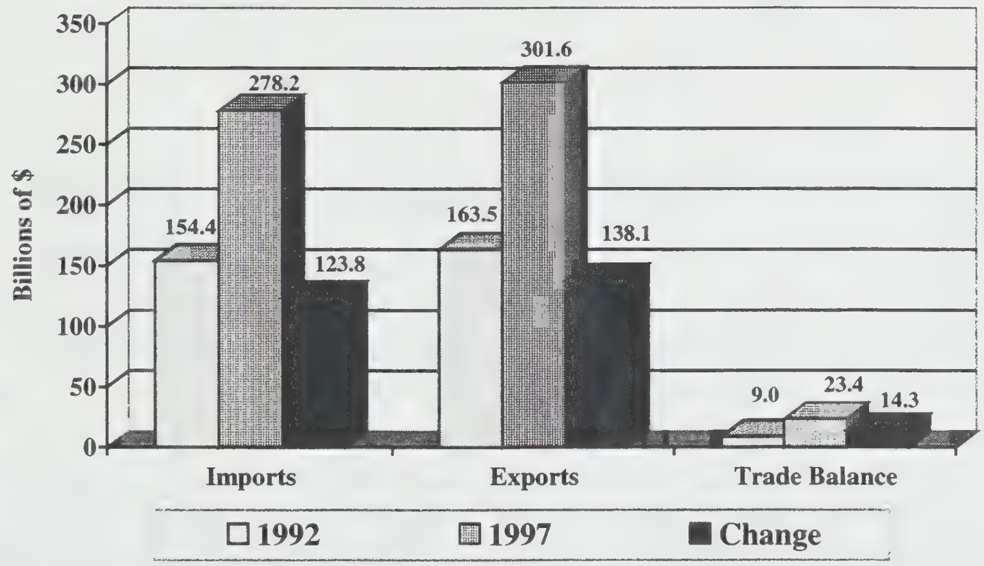
Agriculture, energy and forestry products: In 1997, the combined exports of agriculture, energy and forestry products totalled $87.4 billion, and the combined share in total exports declined from 31% in 1992 to 29% in 1997.

IndustrOial goods: The strong domestic demand for industrial materials in Canada has contributed to import growth of 16.8%, outpacing export growth of 6.4% in 1997. Canadian exports of industrial goods have grown since 1992, despite the changing world demand for industrial materials and increasing technological complexity in that sector.

Merchandise trade balance

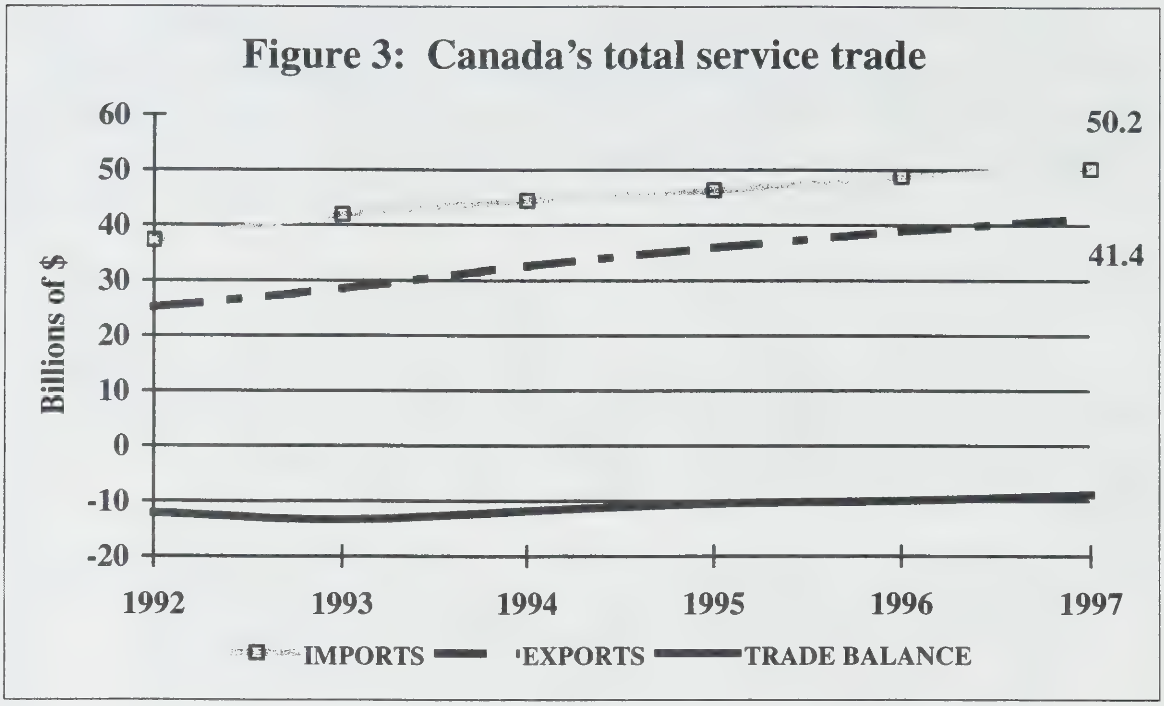
In 1997, both exports and imports finished at record levels. However, imports outpaced exports for the first time since 1992, resulting in a drop of the trade surplus by $17.6 billion, from the record trade surplus of $41 billion in 1996 to $23.4 billion in 1997 (see Figure 2).

Figure 2. Change in Canadian trade of goods, 1992 to 1997



☞ Canada's Trade in Services

Total trade in services consists of (a) travel services, (b) transportation services, (c) government services, and (d) commercial services. Since 1992, the total imports and exports of services have risen at a steady pace and Canada has consistently run a deficit on service trade account as illustrated in Figure 3. However, Canada's trade deficit in services has been narrowing since 1994, primarily due to lower commercial service deficits.



- In 1997, the real exports of services advanced by 4.9% over the 1996 exports.
- The share in total service exports of knowledge-intensive commercial service export increased to 48%, while the corresponding import share of commercial services increased to 43%. This attests to a strengthening of the knowledge-intensive service sector in Canada.

Canada's exports of services totalled $41.4 billion in 1997, up by 6.4% from $38.9 billion in 1996. In 1997, about 58.4% of Canada's service exports went to the U.S., a marginal increase from 56.3% in 1992, while our exports to the EU remained a stable 16% share in 1997 (see Figures 4 and 5). The share of service exports destined to Japan declined marginally to 3.6% in 1997 from 4.4% in 1992.

Canada's imports of services totalled $50.2 billion in 1997, up by 2.9% from $48.8 billion in 1996. The U.S. remained as Canada's major supplier of services, however the share in overall service imports in 1997 declined to 60.2% from 65.2% in 1992. The share of service imports from the EU increased from 15.6% in 1992 to 17% in 1997. The share of service imports from Japan remained relatively stable over the same period (see Figures 6 and 7).

Figure 4. Canada's service exports to selected economies, 1992

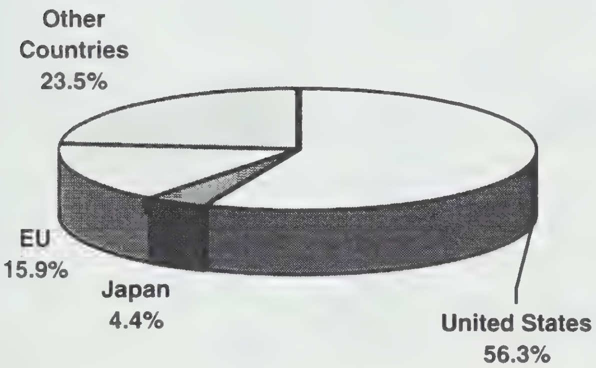


Figure 5. Canada's service exports to selected economies, 1997

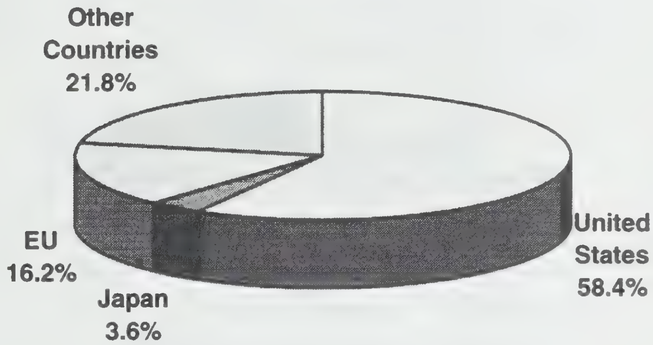


Figure 6. Service imports from selected economies, 1992

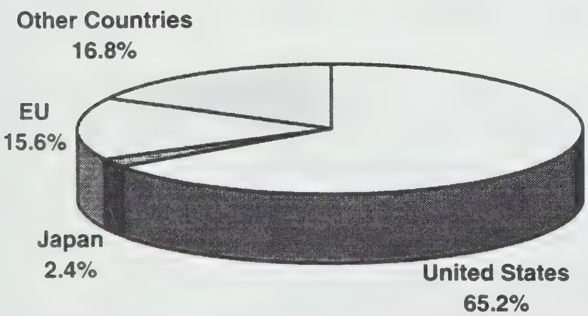
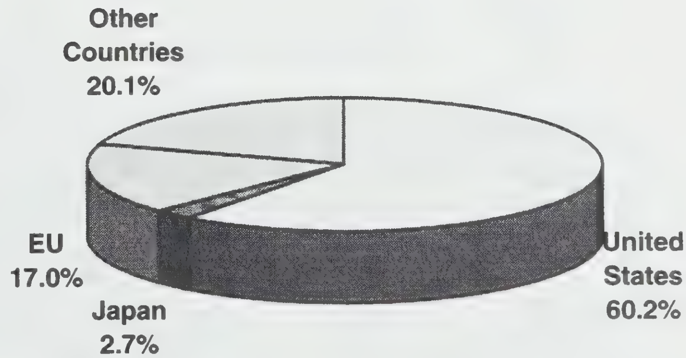


Figure 7. Service imports from selected economies, 1997

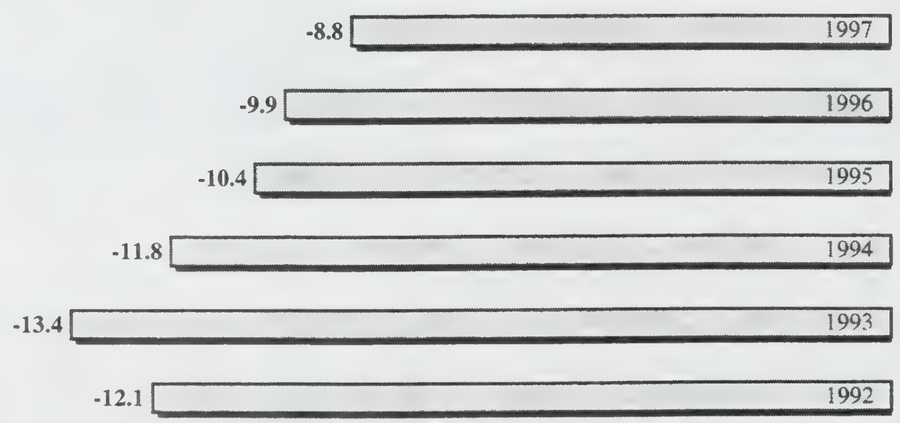


In 1997, the overall deficit on service trade narrowed to $8.8 billion from $12.1 billion in 1992 (see Figure 8). Since 1992, Canada has consistently run a service trade surplus with Japan, but the surplus narrowed to $152 million in 1997. During the same year the service deficit with the U.S. narrowed to $6 billion, down from $10.1 billion in 1992. The service trade deficit with the EU in 1997 was $1.84 billion, a slightly larger deficit than $1.8 billion in 1992 (see Figure 9).

Commercial/business services are the largest component in total Canadian service trade. Table 3 shows that the share of commercial service exports in total service exports had risen from 44% in 1992 to 48% in 1997, and the share of commercial service imports in total service imports increased from 38% in 1992 to 43% in 1997. Consequently, the trade deficit in commercial services declined from $4.1 billion in 1994 to $1.7 billion in 1997, the lowest deficit since 1992.

The increasing importance of commercial services in total services exports between 1992 and 1997 attests to the success of Canadian business in achieving comparative advantage in the production of knowledge-intensive commercial services. Moreover, commercial services are characterized by high-productivity and high real-wage activities.

Figure 8. Canada's service trade balance, 1992-97, billions of dollar



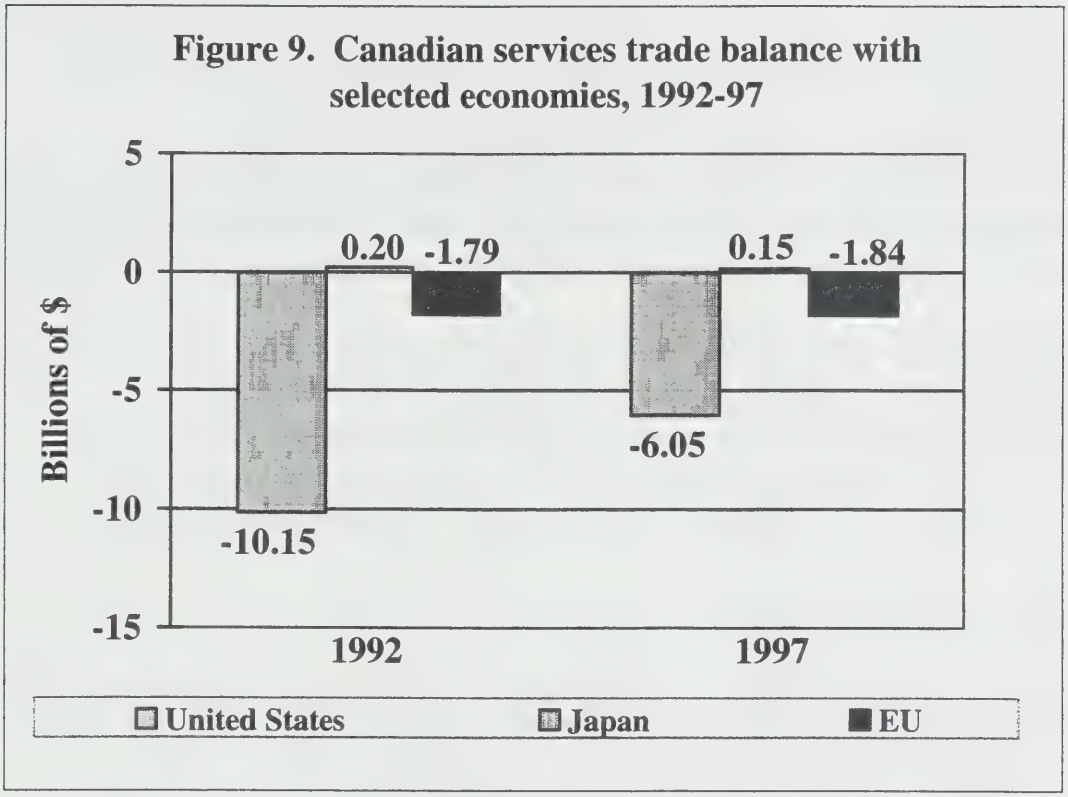


Table 3: Canada's trade of commercial services as a share of total services						
	Imports		*Exports*		*Trade balance*	
	1992	1997	1992	1997	1992	1997
Total Services	$37.3	$50.2	$25.1	$41.4	-$12.1	-$8.8
Total Commercial services	$14.1	$21.5	$11.1	$19.7	-$3.0	-$1.7
Share of commercial services in total	38%	43%	44%	48%	24%	20%

☞ Current account

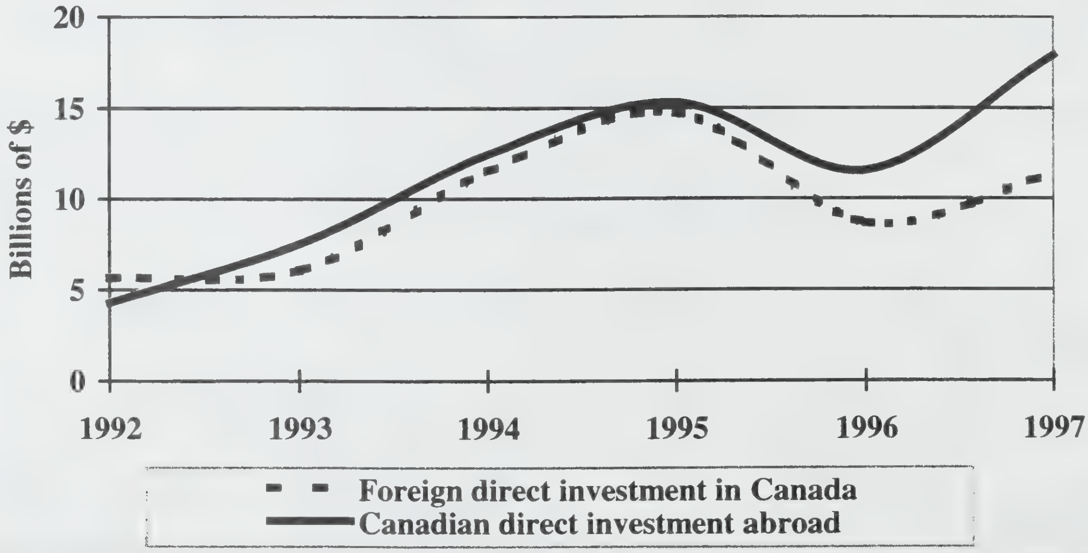
In most of the post-WWII period (1996 being an exceptional year), Canada has run a current account deficit because the surplus of exports over imports has not been sufficient to offset the investment income earned by foreigners in Canada. This long-term trend continued in 1997.

In 1997, strong demand in Canada resulting in imports outpacing exports, contributed to a smaller trade account surplus in goods and services. However, the higher deficit in net investment income flows due to higher profits earned by foreign corporations in Canada has turned the current account surplus of $3.7 billion in 1996 into a $17 billion deficit in 1997.

☞ Financial Account

A current account surplus/deficit (the net total of goods, services and investment income payments) has to be (by definition) offset by the financial/capital account (foreign direct and portfolio investment) or changes in official reserves.

Figure 10. Foreign investment in Canada and Canadian investment abroad, 1992-97



- **Foreign Direct Investment (FDI) in Canada**

The stock of foreign direct investment (FDI) in Canada had increased from $137.9 billion in 1992 to $180.4 billion in 1996. In 1997, the stock of FDI grew by $11.4 billion, a significant increase compared to the inflow of $8.7 billion in 1996, and of $5.7 billion in 1992 (see Figure 10).

- A surge in foreign investment in Canada in 1997 was driven by foreign investors finding Canada a profitable place to invest in. Foreign investment, especially that invested in plant, equipment and production facilities, contributes to the expansion of production capacity and to jobs in Canada.

In 1997, wood, paper, energy, metallic minerals, machinery and transportation equipment industries experienced higher net inflows of FDI compared to those in 1996. By contrast, finance, insurance, services and retailing industries received lower levels of net inflows of FDI in 1997.

The U.S. remained the largest investor of FDI in Canada contributing to 81% of total FDI inflows in 1997. FDI inflows from the U.S. in 1997 totalled $9.3 billion, an increase of about $4 billion over the 1996 level. FDI inflows from the United Kingdom, other EU countries and Japan were lower in comparison to the 1996 level.

Table 4. Annual Increase in Foreign Direct Investment (FDI) in Canada by Industry

Industry Group	FDI stock in 1996 (Millions)	Net FDI increase in 1997 (Millions)	Industry share in total 1997 FDI
Wood and paper	$10,422	$1,429	13%
Energy and metallic minerals	$30,107	$1,567	14%
Machinery and transportation equipment	$27,716	$1,591	14%
Finance and insurance	$32,861	$726	6%
Services and retailing	$17,948	$1,350	12%
Other industries	$61,340	$4,759	42%

Canadian Direct Investment Abroad (CDIA)

The distinguishing feature of foreign investment was that Canadian investment abroad increased to $17.9 billion, an increase of $6.3 billion over the increase in 1996. The stock of Canadian Direct Investment Abroad (CDIA) increased from $111.7 billion in 1992 to $170.8 billion in 1996.

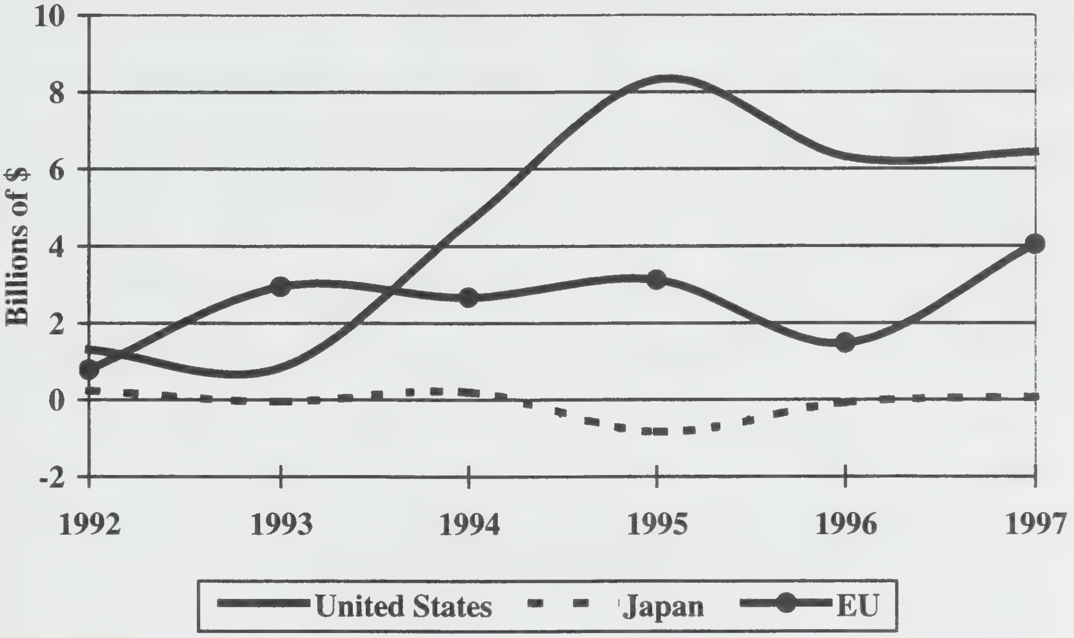
In 1997, the increase in Canadian outward investment was broad-based, but was largely concentrated in energy and metallic minerals, and finance and insurance sectors, each sector accounting for about 31% of the total outflow (see Table 5).

The U.S. was the largest recipient of Canadian direct investment accounting for 36% of total CDIA outflows in 1997. Canadian investment outflows to the U.S. in 1997 totalled $6.4 billion, marginally higher (by about $100 million) than the 1996 outflows to the U.S.. The EU accounted for about 22.5% of the total CDIA and inflows to the EU totalled $4.04 billion in 1997, significantly higher than $1.48 billion in 1996 (see Figure 11).

Table 5. Canadian Direct Investment Abroad (CDIA) by Industry

Industry Group	CDIA stock in 1996 (millions of $)	Net Increase in1997 (millions of $)	Industry share in total 1997 CDIA
Wood and paper	$5,198	$731	4%
Energy and metallic minerals	$39,309	$5,477	31%
Machinery and transportation equipment	$5,489	$1,609	9%
Finance and insurance	$50,038	$5,599	31%
Services and retailing	$24,509	$2,093	12%
Other industries	$46,302	$2,417	13%

Figure 11. Canadian direct investment in selected economies

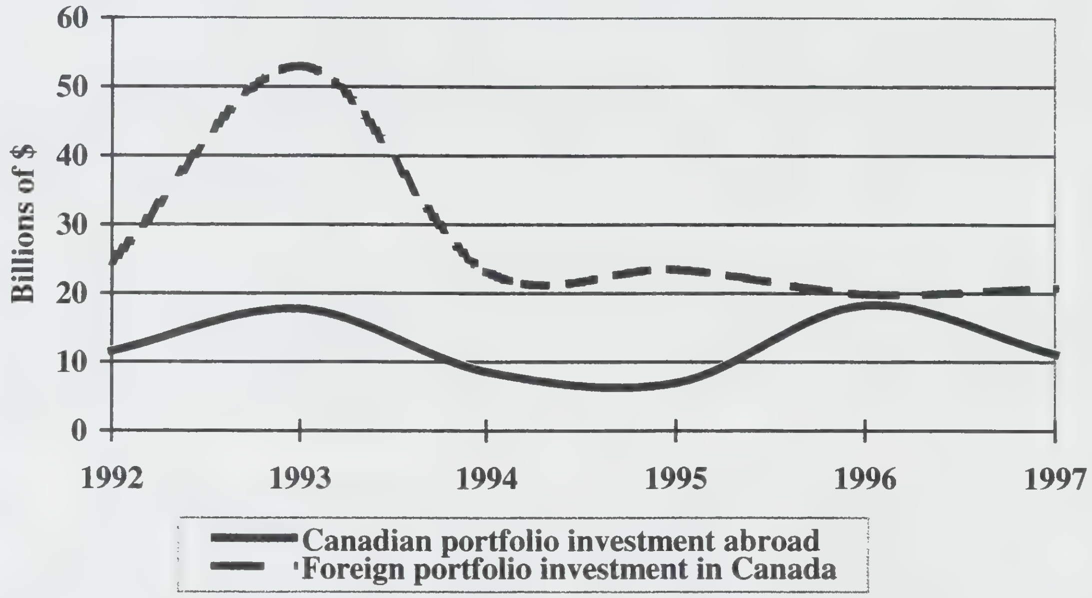


- **Portfolio investment**

In 1997, foreigners injected $21 billion in Canadian portfolio investments (see Figure 12). Foreign investment in bonds and stocks was lower than for 1996. However, investment in short-term money market investments, such as Canadian T-bills and commercial paper, went up substantially after two years of dis-investment.

Canadian portfolio investment abroad in 1997 was $11.4 billion, lower by $7 billion than the record amount in 1996. As a result, Canada had a surplus of $9.6 billion in portfolio investment, higher than that of $1.6 billion in 1996. In 1997, Canadian portfolio investment in foreign bonds was particularly strong, a partial reversal of investment in securities in earlier years.

Figure 12. Foreign portfolio investment in Canada and Canadian portfolio investment abroad



☞ Implications

- Canada's exports in 1997 have continued to expand, though at a slower rate than in banner years 1994 and 1995, but higher than in 1996, as overall economic growth in the EU, Japan and our other export markets decelerated. Canada continues to run a trade account surplus, primarily because of our strong, albeit declining, surplus with the U.S.

- The currently robust domestic economy is triggering strong import growth. A good part of these higher imports is due to purchases of foreign equipment and machinery products. Imports of capital goods increase our economic capacity, with prospects for higher productivity and jobs in Canada in the future.

- Profits earned by foreigners on past direct investment in Canada, combined with a declining trade surplus, are reflected in a widening current account deficit.

- Foreigners are finding profitable investment opportunities in Canada and are investing their savings here. In 1997, Canada experienced higher foreign direct and portfolio investment, which has contributed to a surplus on the financial/capital account.

In sum, the developments on Canada's international balance of payments attest to the success of our exporters and the growing strength of our domestic economy. Moreover, it demonstrates that Canada in 1997 was an attractive site and a safe-haven for foreigners to locate their production and invest money.